

1 IN THE SUPREME COURT OF THE UNITED STATES

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3 A. ELLIOTT ARCHER, ET UX. , :

4 Petitioners :

5 v. : No. 01-1418

6 ARLENE L. WARNER :

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8 Washington, D. C.

9 Monday, January 13, 2003

10 The above-entitled matter came on for oral
11 argument before the Supreme Court of the United States at
12 10:03 a.m.

13 APPEARANCES:

14 CRAIG GOLDBLATT, ESQ., Washington, D. C.; on behalf of the
15 Petitioners.

16 LISA S. BLATT, ESQ., Assistant to the Solicitor General,
17 Department of Justice, Washington, D. C.; on behalf of
18 the United States, as amicus curiae, supporting the
19 Petitioners.

20 DONALD R. AYER, ESQ., Washington, D. C.; on behalf of the
21 Respondent.

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1 P R O C E E D I N G S

2 (10:03 a.m.)

3 CHIEF JUSTICE REHNQUIST: We'll hear argument
4 first this morning in Number 01-1418, A. Elliott Archer
5 versus Arlene L. Warner.

6 Mr. Goldblatt.

7 ORAL ARGUMENT OF CRAIG GOLDBLATT

8 ON BEHALF OF THE PETITIONERS

9 MR. GOLDBLATT: Mr. Chief Justice, and may it
10 please the Court:

11 An individual debtor at the end of a bankruptcy
12 case will typically receive a discharge of that debtor's
13 pre-bankruptcy debts. That discharge, however, is subject
14 to a number of statutory exceptions, each exception
15 reflecting a congressional judgment that a particular
16 category of debt be paid notwithstanding the prior
17 bankruptcy. Those exceptions include not only debts for
18 money obtained by fraud, debts for injuries caused by
19 drunk driving, and amounts due for alimony and child
20 support.

21 With respect to the fraud exception at issue
22 here, under the Bankruptcy Code and this Court's cases, a
23 debt is nondischargeable in bankruptcy if the creditor can
24 establish that the underlying debt arises out of an act of
25 fraud. The question presented in this case is whether a

1 debt that would otherwise be nondischargeable for that
2 reason becomes dischargeable if the parties enter into a
3 settlement agreement that resolves the amount of the debt.

4 The court of appeals said that a settlement did
5 have that effect, emphasizing that the effect of a
6 settlement was to trade a fraud claim for a contract
7 action that would be discharged in bankruptcy.

8 QUESTION: Is it your understanding that if the
9 Fourth Circuit were correct and were to be affirmed in
10 this case, that its rule would be the generally prevailing
11 rule in all of the States, or would certain States differ
12 on whether or not there was, in effect, a novation when
13 there was a settlement agreement? Would we have to go
14 State-by-State?

15 MR. GOLDBLATT: No, Your Honor. The question of
16 dischargeability is a question of Federal law. That is
17 how each of the courts of appeals that have addressed the
18 question has treated it. Indeed, this Court, in Grogan
19 versus Garner, has emphasized that the construction of
20 section 523(a) of the Bankruptcy Code is a question of
21 Federal law.

22 QUESTION: Well, my -- my question, perhaps, was
23 not as clear as it ought to have been. The Fourth Circuit
24 placed substantial reliance on the fact that this was a
25 novation under State law, that there was a new debt

1 created superseding the old, et cetera, and my question is
2 whether or not -- if we affirm its judgment, that we will
3 find in almost every other State a settlement is also a
4 novation, or will the rule vary from State to State, and
5 if it does vary from State to State, will the Fourth
6 Circuit rule from this particular State be the majority
7 rule or minority?

8 MR. GOLDBLATT: Your Honor, the court of appeals
9 did, indeed, say that the -- the settlement effected a
10 novation. That is a common rule. I'm unaware of any
11 jurisdiction in which that -- that wouldn't be the
12 principle. The question, nevertheless, before this Court
13 is the effect as a matter of Federal bankruptcy law of
14 that settlement.

15 QUESTION: I'm -- I'm well aware of that, but
16 what I'm just asking is -- this case came from South
17 Carolina, was it?

18 MR. GOLDBLATT: From North Carolina, Your Honor.

19 QUESTION: Oh, from North Carolina.

20 MR. GOLDBLATT: Yes.

21 QUESTION: Is the North Carolina rule about
22 novations and settlements the majority rule for most of
23 the States? In most States, would this be called a
24 novation?

25 MR. GOLDBLATT: Yes, Your Honor. I'm unaware of

1 any jurisdiction in which a settlement doesn't effect
2 novation. When the parties to a dispute settle that
3 dispute, it is commonly the case that -- indeed, in every
4 jurisdiction of which I'm aware, following that
5 settlement, the -- the creditor or the plaintiff is unable
6 to bring a new lawsuit for fraud. Rather, the party is
7 left to enforce the -- the settlement.

8 QUESTION: Mr. Goldblatt, I take it you're
9 saying, yeah, a novation is fine with you. No longer do
10 they have the original claim. They have substituted for
11 it, what the claim is, the amount of the settlement.
12 The -- what was it, immediate payment of X dollars? Was
13 it 2,000?

14 MR. GOLDBLATT: It was an immediate payment of
15 \$200,000 and a promissory note for \$100,000.

16 QUESTION: And that's -- that's what they --
17 they say is the basis of their claim in bankruptcy. They
18 think -- they know they can't go back to the original
19 claim. To that extent, it's a novation. That's not
20 disputed. But there is one element of the background of
21 this case perhaps you can clarify for me. It's odd that
22 Leonard Warner stipulated that this was a nondischargeable
23 debt, but his wife, who's in the bankruptcy with him, says
24 yes, it is dischargeable. What is the effect of the
25 stipulation by Leonard Warner that this debt is

1 nondischargeable?

2 MR. GOLDBLATT: Your Honor, Leonard Warner
3 stipulates that the debt is nondischargeable as to him
4 With respect to Mrs. Warner, it would remain our burden in
5 bankruptcy to show that -- that there is an act of fraud
6 that is properly attributable to her, either because she
7 committed it herself or by some principle of agency that
8 it is nondischargeable because of her, so I -- I don't
9 believe that the -- the stipulation by its terms is -- is
10 dispositive on the question of whether it is
11 nondischargeable as -- as to her.

12 QUESTION: But does that mean that -- let's say
13 the Fourth Circuit is affirmed, that you could still,
14 post-bankruptcy, go after Mr. Warner because he stipulated
15 that the debt as to him was nondischargeable?

16 MR. GOLDBLATT: I -- I believe that -- that's a
17 final and unappealable order at this point, and yes,
18 that's right, of course. Petitioners assert that they
19 have the right as a matter of Federal bankruptcy law also
20 to continue to recover on this debt as against
21 Mrs. Warner, who also is an obligor on the promissory
22 note.

23 On the essential point that, Justice Ginsburg,
24 you were making with respect to the holding below, the
25 description you offered is -- is exactly right. It is

1 true that there is a novation. It is true that the
2 underlying claim of fraud has been released, but just --
3 that was equally true in this Court's decision in Brown
4 versus Felsen.

5 In Brown, the parties to a State court
6 litigation resolved that litigation by agreeing to the
7 entry of a consent judgment. It was as equally true
8 there, as it is here, that the parties who had been --
9 whose litigation had ended in the consent judgment were
10 barred, in that case by the preclusive effect of the
11 consent judgment, here by the binding effect of the
12 settlement, from bringing a new suit claiming fraud. All
13 they could do was enforce the consent judgment.

14 Nevertheless, this Court held in a unanimous
15 opinion in Brown versus Felsen that in bankruptcy, the
16 creditor nevertheless had the right to seek to establish
17 that the underlying debt arises out of an act of fraud,
18 and the -- the reason this Court --

19 QUESTION: Well, of course, there it wasn't just
20 the underlying debt. It was trying to find out what the
21 judgment actually decided. They were -- they were able to
22 go beyond the terms of the judgment to determine what the
23 judgment actually resolved. I'm not quite sure it's
24 exactly parallel --

25 MR. GOLDBLATT: Well, yes, Justice Stevens,

1 that's right, and here what -- what petitioners seek to do
2 is go behind the settlement agreement --

3 QUESTION: Yes.

4 MR. GOLDBLATT: -- and see what the settlement
5 actually resolved.

6 QUESTION: Supposing the settlement -- they had
7 gone along with the settlement, and then they came up with
8 a -- a third proposal where the debtor said, I'm not sure
9 I'm going to be able to meet my obligations, but I've got
10 another proposal, we'll go in the joint venture to do
11 something else and we'll release the contract claim and
12 substitute a third, could you go -- still continue to go
13 behind to find out what the original source of the debt
14 was?

15 MR. GOLDBLATT: Yes. Yes, Your Honor.

16 QUESTION: So even if, say, they had five or six
17 different transactions, each of which purported to be a
18 complete substitute for the deal they had just been unable
19 to -- you can always go -- say, Well, the whole thing
20 started because you cheated me out of something?

21 MR. GOLDBLATT: Well -- well, for each
22 particular debt that one asserts is nondischargeable, the
23 creditor bears the burden of proving in bankruptcy that
24 that debt arises out of an act of fraud.

25 QUESTION: Directly or indirectly out of.

1 MR. GOLDBLATT: That's right, but nevertheless,
2 under Brown versus Felsen, that is the creditor's --

3 QUESTION: Suppose I have an indebtedness. I'm
4 running a business and I have one indebtedness, and in
5 order to cover the payments for that indebtedness, I incur
6 a second indebtedness which I otherwise would not have
7 incurred, is that traceable to fraud?

8 MR. GOLDBLATT: If the original indebtedness
9 arises out of an act of fraud, Justice Scalia, then --
10 then yes, it is all debt --

11 QUESTION: Anything that happens later is --
12 that -- that wouldn't have happened but for the original
13 indebtedness is, within the terms of the Bankruptcy Act,
14 traceable to the fraud?

15 MR. GOLDBLATT: Justice Scalia, we -- we
16 certainly acknowledge that there must be some principle
17 of, say, proximate causation.

18 QUESTION: Exactly, and that's all we're talking
19 about here, isn't -- isn't it? How -- how -- you know,
20 how far down the line do we carry traceable to, and does a
21 novation end the traceability, but you -- you have to
22 acknowledge it has to end somewhere.

23 MR. GOLDBLATT: There certainly is a principle
24 of proximate causation. You -- you need to show that
25 there is a direct connection between the act of fraud --

1 QUESTION: Wait, but what about -- I mean, this
2 doesn't make too much sense to me. You say, A owes B
3 \$100,000 because of a fraud that A committed against B, so
4 they settle it, and they say, our settlement arrangement
5 is the following. We enter into a new business called
6 Macy's Department Store, and many years later there's
7 another debt between the partners arising out of buying
8 furniture for Macy's that has nothing to do with fraud,
9 and now you're saying that that debt's going to be never
10 dischargeable because the cause of Macy's was the fraud?

11 MR. GOLDBLATT: No, Justice Breyer, I'm not
12 suggesting that there is never a point in which the
13 causation becomes too tenuous that you can't prove that
14 the debt that one is contending is --

15 QUESTION: No, I -- absolutely. Macy's would
16 never have been created but for the debt, no doubt about
17 that.

18 MR. GOLDBLATT: But not -- not only is -- is the
19 principle of --

20 QUESTION: They never would have had this
21 furniture argument but for the debt.

22 QUESTION: Well, you're talking not just about
23 cause, but proximate cause.

24 MR. GOLDBLATT: Exactly. It's not just a
25 question of but-for causation, but as in common law,

1 proximate causation.

2 QUESTION: And what does that mean, proximate
3 cause, then? What's the difference between this case and
4 Macy's?

5 MR. GOLDBLATT: Your Honor, here, all that
6 happened is that the -- the form of the debt changed. The
7 parties entered into a settlement agreement in which they
8 changed the debt from an unliquidated cause of action for
9 fraud into a liquidated promissory note.

10 QUESTION: In -- in connection with that, one
11 side said to the other, I don't care whether this has come
12 out of fraud or not. Regardless of whether it came out of
13 fraud, I'm going to give you this money, and we'll be
14 quits. Why isn't that enough to terminate the proximity,
15 because the averment of both parties is, never mind fraud,
16 it doesn't have anything to do with fraud, we're going to
17 settle this. Whether there was fraud or whether there
18 wasn't fraud, you get the money.

19 MR. GOLDBLATT: That -- that's right, Your
20 Honor, and all a creditor seeks to do in showing a debt as
21 nondischargeable is seeks to enforce the debtor's promise
22 to pay the amount of money given in that settlement.

23 QUESTION: That's true, but -- but here it
24 was -- there was no acknowledgement of the fraud. It was
25 given with the averment that this debt does not hinge upon

1 fraud. This debt is just to settle this controversy
2 between us whether there was fraud or whether there wasn't
3 fraud.

4 MR. GOLDBLATT: That's --

5 QUESTION: Why isn't that enough to terminate
6 the proximity necessary for -- for nondischargeability in
7 bankruptcy?

8 MR. GOLDBLATT: Just a couple of -- of answers.
9 First, it -- it doesn't terminate the proximity any more
10 than the consent judgment in Brown versus Felsen might
11 have terminated the proximity in that case. It's, of
12 course, true that a -- a consent judgment operates as a --
13 extinguishes the prior cause of action and the claims
14 merge into the consent judgment.

15 Nevertheless, this Court said in Brown versus
16 Felsen that notwithstanding the preclusive effect of that
17 judgment, a creditor has the right in bankruptcy to
18 establish that the debt is traceable to fraud, and what it
19 said is --

20 QUESTION: But doesn't a consent judgment
21 always, at -- always hinge upon the existence of a cause
22 of action?

23 MR. GOLDBLATT: Presumably yes, Your Honor,
24 and --

25 QUESTION: Whereas a settlement doesn't.

1 MR. GOLDBLATT: That's right, and unless the
2 creditor can prove in bankruptcy that the debt that's now
3 reflected in -- in the settlement agreement is traceable
4 to an act of fraud, the creditor will lose the
5 nondischargeability action, and the only question is
6 whether the creditor should have the opportunity to
7 establish in bankruptcy that there is, in fact, an act of
8 fraud that -- that is reflected in and resolved by the
9 consent judgment.

10 The consent judgment says expressly -- it
11 doesn't say there's no fraud. It says that this is a
12 compromise of disputed claims, and in exchange for the
13 release, what the creditor got was a clear carve-out from
14 that release for the right to enforce the \$100,000 of debt
15 that's reflected in the promissory note.

16 QUESTION: It doesn't say there's no fraud, but
17 it does say that this indebtedness has nothing to do with
18 whether or not there was fraud. Whether or not there was
19 fraud --

20 MR. GOLDBLATT: That's right. The settlement --

21 QUESTION: -- this indebtedness exists. It
22 seems to me it severs the connection between the fraud and
23 the indebtedness.

24 MR. GOLDBLATT: But it is completely silent on
25 the question of whether fraud had occurred, just as the

1 consent judgment in Brown v. Felsen was completely silent
2 on the question whether that debt arose out of contract or
3 fraud. In Brown, this Court said that the creditor has
4 the opportunity to look behind the fraud -- to look behind
5 the settlement to determine whether or not it was for
6 fraud, and there -- there's no difference here.

7 Your Honor --

8 QUESTION: Would there be -- would there be a
9 difference if the settlement had expressly said, we
10 stipulate that there was no fraud leading to the creation
11 of the debt of -- for which this in effect is a -- a
12 novation?

13 MR. GOLDBLATT: Justice Souter --

14 QUESTION: Would that make a difference?

15 MR. GOLDBLATT: Justice Souter, that would be a
16 much harder case for reasons we set out in -- in our
17 briefs. We contend as a matter of bankruptcy policy there
18 are reasons why such an agreement shouldn't be enforced,
19 but that would certainly be a much more difficult case
20 than this one.

21 QUESTION: But your argument here is we don't
22 really have get to bankruptcy policy. There simply has
23 not been an agreement which eliminates the fraudulent
24 character of the debt. Is that basically it?

25 MR. GOLDBLATT: That's -- that's exactly right,

1 Justice Souter.

2 The way this works in bankruptcy is that when
3 the creditor files for bankruptcy with this promissory
4 note outstanding for a hundred-and-some-thousand dollars,
5 the creditor comes into bankruptcy and files a proof of
6 claim saying, I have a claim of a hundred-and-some-
7 thousand dollars, and I'm entitled to my pro rata
8 distribution on that hundred-and-some-thousand dollars.
9 The proof of claim is on page 82 of the joint appendix.

10 No one's contending that the release bars the
11 creditor from seeking recovery on the amount of that debt.
12 The only question is whether they can receive recovery in
13 the full amount of the debt by showing it's
14 nondischargeable, or whether they're limited to simply the
15 cents on the dollar that the claim will pay in bankruptcy,
16 because the text of the Bankruptcy Code makes clear that
17 the form of the debt doesn't matter, that a debt -- that
18 under section 523, a debt can take any number of
19 different -- under -- I'm sorry.

20 Under section 523 of the Bankruptcy Code, any
21 debt, the code says, is nondischargeable if it's traceable
22 to an act of fraud, and the code defines debt very broadly
23 to include debts that are liquidated, unliquidated,
24 reduced to judgment, et cetera. It's quite clear the form
25 of the debt doesn't matter, unless --

1 QUESTION: But the traceability does, and that's
2 what we're talking about here, how traceable is traceable.

3 MR. GOLDBLATT: That's right, Justice Scalia,
4 and with respect to that question there is -- there is no
5 difference between a consent judgment that is a final
6 adjudication of the claims between the parties and a
7 settlement agreement, both of which are equally
8 preclusive, both of which are equally silent on the
9 question of whether fraud occurred.

10 Unless the Court has further questions, I'll
11 reserve the balance of my time.

12 QUESTION: Thank you, Mr. Goldblatt.

13 MS. BLATT, we'll hear from you.

14 ORAL ARGUMENT OF LISA S. BLATT

15 ON BEHALF OF THE UNITED STATES, AS AMICUS CURIAE,

16 SUPPORTING THE PETITIONERS

17 MS. BLATT: Thank you, Mr. Chief Justice, and
18 may it please the Court:

19 When a creditor settles a fraud claim without
20 resolving the disputed issue of fraud, the creditor has
21 the right to enforce the settlement debt for the full
22 amount in bankruptcy by filing a proof of claim and by
23 establishing fraud in response to the defense of
24 dischargeability. That conclusion is confirmed by Brown,
25 which held that a creditor who settles a fraud claim by

1 consent judgment may establish fraud in response to a
2 bankruptcy --

3 QUESTION: But the real inquiry in Brown, as I
4 read it, is can we go behind a judgment to see what was
5 actually determined by the judgment. It wasn't any
6 emphasis on the settlement aspect of it, as I read the
7 opinion.

8 MS. BLATT: Right.

9 QUESTION: And I guess the holding is, yes, you
10 may go behind a judgment to see what was decided, and that
11 seems to me a little different from going behind a
12 settlement.

13 QUESTION: Well, didn't Brown decide two
14 separate issues?

15 MS. BLATT: The Court in Brown did two things.
16 The court -- the question of fraud was not litigated in
17 Brown because the case was settled, and the Court
18 mentioned in its last footnote that there would be a
19 different situation if the question of fraud was actually
20 litigated.

21 The question before the bankruptcy court in
22 Brown is whether the money owed under that consent
23 judgment was money obtained by fraud. So, too, the exact
24 same question is relevant here.

25 QUESTION: It didn't look to what the Court had

1 decided, but what the claim was about, but here we have
2 something in addition. There is a judicial order. There
3 was a complaint filed, and it was dismissed as part of the
4 settlement. That complaint in the court action was
5 dismissed with prejudice. What effect should that have?

6 MS. BLATT: Not -- a dismissal with prejudice
7 following a settlement. As this Court stated in Lawlor
8 versus National Screen Service, it's cited in the reply
9 brief at page 9, is that it has -- does not have
10 preclusive effect on the disputed issue unless the
11 judgment is accompanied by specific findings on the
12 disputed issue, and that's the classic requirement for
13 issue preclusion or collateral estoppel, that the matter
14 be actually litigated.

15 QUESTION: We're not talking issue preclusion,
16 just -- just as far as whether it suffices to terminate
17 the traceability. That -- that isn't necessarily
18 coextensive with -- with whether there was issue
19 preclusion.

20 MS. BLATT: No, the -- the dismissal with
21 prejudice doesn't impair the creditor's right to walk into
22 court and sue to enforce the settlement debt, including
23 the right to try to get the full amount of the settlement
24 debt in bankruptcy, and on this issue of traceability,
25 it -- it is not only identical to Brown, but the code by

1 its express terms disclaims any distinction between a
2 liquidated debt and an unliquidated debt. The settlement
3 in Brown and the settlement here converts an unliquidated
4 fraud claim into a liquidated claim to collect on the
5 settlement debt.

6 QUESTION: May I -- would you just clear up one
7 thing for me? Say the fraud claim was for \$300,000 and
8 the contract was -- the novation was \$200,000, in the
9 bankruptcy court do you contend they can get the full 300
10 or just the 200?

11 MS. BLATT: No. Under -- under -- he would
12 be -- the -- the creditor would be bound by the settlement
13 agreement under principles of State law that the amount of
14 his debt would only be the \$200,000.

15 QUESTION: It seems like a strange result,
16 doesn't it?

17 QUESTION: I don't understand that.

18 QUESTION: Why shouldn't he --

19 QUESTION: You conduct this big inquiry and find
20 out that the guy's been defrauded of \$300, and then that
21 the settlement agreement really covers up a fraud and you
22 say, Well, but you know, a deal's a deal. Even though you
23 defrauded him of it and the whole thing's traceable to
24 fraud, we're only going to give you \$200,000. That's very
25 strange.

1 MS. BLATT: I'm sorry, are you talking about the
2 settlement agreement itself was procured by fraud?

3 QUESTION: No, no, no, no. No, the settlement
4 agreement was just an arm's-length agreement, but if you
5 find that, in fact, the debt underlying that -- that
6 agreement was fraudulently obtained, having gone through
7 all the trouble of determining that fact, why don't you
8 make the guy cough up all the money that he got by fraud?

9 MS. BLATT: The Court -- The Court addressed
10 this very issue in Brown. The creditor there did not get
11 a fraud judgment for exemplary damages and special --
12 special damages under State law. He was limited to, in
13 bankruptcy, of just seeking this settlement debt, and what
14 the bankruptcy code does is, it gives the creditor a
15 statutory right to render that settlement debt
16 nondischargeable if fraud can be -- can be shown.

17 You don't -- and there's another way of looking
18 at it, too. The Court --

19 QUESTION: But -- but what's the policy reason
20 behind that. I mean, if -- if what we're concerned about
21 is vindicating the Federal policy that the -- the
22 Bankruptcy Code protects only honest debtors and not
23 dishonest debtors, why not give them the whole \$300,000?
24 I mean, I -- I know Brown didn't do that, but why didn't
25 it do that?

1 MS. BLATT: The Court in Grogan -- it's because
2 of two issues, Justice Kennedy. Under State -- State law
3 determines the amount of the debt that is owed, and
4 there's just no question, at least I don't think that the
5 creditor could make an argument that he's owed any more
6 than \$300,000. He can't relitigate and try to get up to
7 \$600,000. That's just governed by State law.

8 QUESTION: Well, the Fourth -- the Fourth
9 Circuit says State law says that this is a novation, too,
10 so -- and you're -- you don't want us to be bound by that
11 interpretation of State law.

12 MS. BLATT: The -- again, this Court in Grogan
13 versus Carter said that State law determines the amount of
14 the debt, and I just don't think the creditor would have a
15 good faith argument that he could go beyond the settlement
16 agreement, but on the question of nondischargeability,
17 what the creditor is trying to do is collect the entire
18 amount of the debt by -- by showing fraud, and we think
19 applying Brown --

20 QUESTION: What their main argument, I think, on
21 the other side is, you get a debt, that's what it is, a
22 debt for money obtained by fraud, and this is not a debt
23 for money obtained by fraud, this is a debt for money owed
24 under a settlement agreement.

25 Now, the virtue of that is, it's a bright line,

1 and what we're saying, I think, in the negative -- the
2 negative of it is that if you depart from that, well
3 there's no end to it. You have a settlement agreement,
4 and no matter how long you go into the future, whatever it
5 is, that -- whatever it says you're supposed to do in that
6 settlement agreement, it is. Use the words proximate
7 cause, use whatever they want, but it is a debt. Where it
8 comes from is the fraud.

9 That's where the source of the debt is, no
10 matter what it says in that settlement agreement, and
11 there's just no stopping place, no way to look into it, no
12 attenuation forever, et cetera, so that's what I'd like
13 you to here address.

14 MS. BLATT: Well, this Court already crossed
15 that bridge in Brown.

16 QUESTION: Well, all right, so then maybe Brown
17 was wrong.

18 MS. BLATT: But the second point is that --

19 QUESTION: Maybe it was wrong.

20 MS. BLATT: Whatever the limits of the
21 traceability point, which this Court addressed in a
22 separate decision, Cohen versus de la Cruz, which dealt
23 with the traceability aspects --

24 QUESTION: There is no traceability. There's
25 never a problem. Underlying this was the fraud. Whatever

1 it says in that settlement agreement is based on fraud.

2 MS. BLATT: The code itself says that any
3 enforceability obligation, whether or not it's liquidated
4 or unliquidated or appears in a judgment, if you can prove
5 that there has been a fraudulent acquisition of money, the
6 resulting debt is nondischargeable, and that is --

7 QUESTION: Ms. Blatt, what is your -- what is
8 the Government's position if the parties had expressly
9 dealt with it in the settlement agreement?

10 MS. BLATT: We think the right would be subject
11 to waiver. We don't think -- we don't see anything in the
12 code that would be --

13 QUESTION: So you don't agree with petitioner's
14 counsel that it's a harder case, but wouldn't give it up?

15 MS. BLATT: We think the right can be waived.
16 What we do think, though --

17 QUESTION: All right, now, the language in this
18 particular settlement agreement gave up claims arising out
19 of or relating to the matter of the State court
20 litigation. Was that not a waiver of this claim?

21 MS. BLATT: No, it certainly wasn't a waiver of
22 the right to collect on the debt, and in fact there's an
23 express preservation of not only the right to collect all
24 the obligations under the promissory note, but to collect
25 the amounts under the settlement agreement, and we think

1 to apply a contrary rule, the rule that the court below
2 applied, would be unsound for three reasons.

3 It would force creditors and parties trying to
4 settle a case to start negotiating over bankruptcy
5 contingencies that are purely hypothetical, may never
6 happen, and are entirely extraneous to the settlement.
7 The rule adopted by Brown also, our second point, is that
8 it reflects the common sense and ordinary understanding
9 that settlements preserve the creditor's right to enforce
10 the settlement agreement and the statutory right to prove
11 fraud to render the debt enforceable, notwithstanding
12 bankruptcy, and that has been the premise of hundreds, if
13 not thousands of settlement agreements entered into by the
14 Government that do not refer to bankruptcy contingencies.

15 Third, to hold that those settlement agreements
16 waive the creditor's rights in bankruptcy would render
17 debts dischargeable even where the debtor committed fraud,
18 and that result would undermine congressional policy to
19 favor the rights of innocent victims of fraud over the
20 perpetrators of fraud.

21 QUESTION: But you do agree that some fraud
22 claims could be waived as far as the dischargeability,
23 because you wrote the rights settlement agreement.

24 MS. BLATT: Yes, if there was an affirmative
25 manifestation of an intent.

1 QUESTION: Why isn't that inconsistent with the
2 statutory policy, just as this case would be?

3 MS. BLATT: Because there is a background
4 presumption, Justice Stevens, that rights are subject to
5 waiver, and so if there's an intentional relinquishment of
6 a Federal statutory right, then a court can give that
7 effect, but not only is there silence on that issue in
8 this case, there is an express reservation of the right to
9 enforce the settlement agreement, and --

10 QUESTION: To enforce the settlement agreement.

11 MS. BLATT: Yes, and that includes --

12 QUESTION: But that's not a reservation of the
13 right to sue for fraud.

14 MS. BLATT: They're not suing for fraud.
15 They're suing to collect on the settlement agreement for
16 the full amount in bankruptcy. By asking the bankruptcy
17 court, not only by filing the proof of claim, but to
18 render the debt survivable and enforceable in bankruptcy.
19 It's no different than the settlement judgment in -- in
20 Brown.

21 QUESTION: Thank you, Ms. Blatt.

22 Mr. Ayer, we'll hear from you.

23 ORAL ARGUMENT OF DONALD B. AYER

24 ON BEHALF OF THE RESPONDENT

25 MR. AYER: Thank you, Mr. Chief Justice, and may

1 it please the Court:

2 I would like to make four points this morning.
3 The first one, to pick up on what Justice O'Connor said, I
4 think there's a fundamental misconception in the question
5 as it's presented and as it was described by Mr. Goldblatt
6 this morning, and this conception is that what we're
7 dealing with here is a categorical rule that says that
8 whenever you have a settlement, because it's a contract,
9 it bars any further pursuit of a nondischarge claim

10 That is completely inconsistent with the
11 holdings of the court below, all of which looked
12 specifically at the language of the release and concluded
13 that what had specifically been released was the right to
14 pursue the claim under 523.

15 Second --

16 QUESTION: This would have been a release in
17 State court proceedings?

18 MR. AYER: Correct, Your Honor, and -- and that
19 leads to the second point, which is that what is at issue
20 here really is the interpretation of the language, the
21 specific language --

22 QUESTION: There's no language about 523, which
23 you just said --

24 MR. AYER: That's correct, Your Honor.

25 QUESTION: -- this is a standard settlement.

1 It's a compromise. Neither side is admitting anything.
2 One side is not admitting fraud, and the other side isn't
3 saying we've proved fraud. It's just a zero on there.

4 MR. AYER: Well, Your Honor, I think what you
5 said in terms of the language is certainly correct.
6 I think the important issue is that this is a settlement
7 and, indeed, there is also a -- a voluntary dismissal with
8 prejudice in a State court case. I would submit the
9 proper analysis of that is to interpret the settlement
10 under State law and then ask the question, is there some
11 problem with Federal bankruptcy law that requires you to
12 somehow override what's been agreed to or what's been done
13 in State court.

14 QUESTION: But isn't -- isn't the problem with
15 approaching it that way -- I -- at least, I think the
16 problem with approaching it that way is that there is no
17 State law analog to the issue that is being raised here.
18 In other words, under -- under State law, there was a
19 fraud claim, there was a settlement of the fraud claim,
20 but there is no issue under State law about bankruptcy,
21 and that is strictly a -- a Federal policy --

22 MR. AYER: Well --

23 QUESTION: -- and I don't know how we get --
24 we -- we look to State law to find out whether there is
25 doubt or not, but I don't know why State law should be a

1 source of an answer to this Federal question, which is
2 peculiarly Federal.

3 MR. AYER: Well, I -- I don't think, Your Honor,
4 that it is the final answer, but it seems to me it's
5 entirely possible for parties in a State court proceeding
6 to enter into a settlement that says, and we hereby
7 specifically release our 523 claim, and had that been --

8 QUESTION: They -- they might be able to -- I
9 mean, I'll assume for the sake of argument that they might
10 be able to do that, but in -- in that case, the -- the
11 issue here would be resolved, on -- on your theory,
12 certainly, by the express agreement with the parties, and
13 they didn't do that, so we've got a case in which they
14 didn't agree on the issue expressly, and I don't see why
15 State law, which doesn't have the issue, is a good place
16 to look for the answer.

17 MR. AYER: Well, I think -- I guess my point,
18 Your Honor, is that the question of whether they expressly
19 agreed to it becomes a question of interpretation, and I
20 would like to get to arguing that they did, in fact,
21 expressly agree to it. The first --

22 QUESTION: Well, didn't Brown versus Felsen
23 suggest some discouragement to the idea of anticipatory
24 litigation in State courts of issues that would arise in
25 bankruptcy court?

1 MR. AYER: I -- I think Brown versus Felsen
2 certainly expressed the view that they didn't want to
3 encourage people to have to affirmatively determine fraud
4 in State court when it had been, in fact, been -- been --
5 the issue of nondischargeability had been put into the
6 bankruptcy court, but nothing in Brown versus Felsen in
7 any way qualifies the proposition that parties can, in a
8 State court proceeding, resolve, for example, by trial an
9 issue of fraud that would be preclusive under collateral
10 estoppel.

11 QUESTION: You say it doesn't qualify the
12 proposition. It doesn't address the proposition.

13 MR. AYER: Correct.

14 QUESTION: Suppose --

15 MR. AYER: But it does, Your Honor, address it
16 in the sense, and then Grogan confirms that collateral
17 estoppel does apply, so that if you have a State
18 proceeding --

19 QUESTION: There's -- there's no collateral
20 estoppel here. That argument absolutely dumbfounded me,
21 frankly, because for collateral estoppel, issue
22 preclusion, you must have raised, actually litigated,
23 there must be a court determination of the issue, and that
24 determination must be essential to the judgment. You
25 don't have any actual litigation here, so I don't know how

1 you can --

2 MR. AYER: Your Honor, under this Court's
3 Matsushita decision, it is perfectly clear that in order
4 to determine whether there's issue preclusion, you have to
5 look at the State law in the State where the judgment is
6 entered, and -- and the State law, as we indicate in our
7 brief, in North Carolina is that if you have a voluntary
8 dismissal with prejudice under the Miller Building case,
9 under the Barnes case, that voluntary dismissal with
10 prejudice resolves the issues that were put in issue --

11 QUESTION: The only decision that you cite from
12 the North Carolina supreme court says, we go down the line
13 with what is the standard understanding of issue
14 preclusion, actually litigated, decided, and essential to
15 the judgment.

16 MR. AYER: Your Honor, I --

17 QUESTION: That's what the North Carolina
18 supreme court said.

19 MR. AYER: I disagree, Your Honor. The -- the
20 Thomas McInnis case that you're referring to is a case
21 where what actually happened with regard to the issue of
22 whether prejudgment interest was available was that a
23 husband, in litigating that issue, in fact, failed to
24 timely raise it, and when he failed to timely raise it,
25 the wife was subsequently collaterally estopped from

1 pursuing it.

2 There's one sentence in the Thomas McInnis case
3 that says, we apply the usual principles of collateral
4 estoppel. There are multiple cases, Your Honor, in North
5 Carolina that are entirely clear that the rule is that if
6 you have a voluntary dismissal with prejudice, that
7 voluntary dismissal is determinative as though the matter,
8 and this of -- almost a quote, as though --

9 QUESTION: Well, that would certainly run
10 entirely against the stream, and it would run against the
11 Restatement of Judgments, which you cite, and that says
12 you must manifest -- yes, parties can make a stipulation
13 finding. They can do it in a consent judgment just as
14 they can in the settlement, but they have to make that
15 manifest.

16 MR. AYER: Right.

17 QUESTION: The court does not infer that an
18 issue that was never litigated was, in fact, decided.

19 MR. AYER: I guess what -- what I would like to
20 suggest to -- to the Court is that what we do have here is
21 a settlement of a State court litigation followed by a
22 voluntary dismissal with prejudice, that the effect of
23 that, of those acts, including the language, because
24 that's what the courts here -- all three of these courts
25 focus specifically on the precise language, and they

1 concluded that that language was a waiver. I would submit
2 that was --

3 QUESTION: Well, if they concluded that it's a
4 waiver of claim, and we don't have any -- I presume no one
5 has a problem with that. The question is whether there
6 is -- is a waiver on the disputed fact issue, and -- and
7 my -- my question to you is, you -- you refer to the
8 myriad State law cases that hold in your favor. Is it
9 clear that those are cases on issue preclusion --

10 MR. AYER: Yes, Your Honor.

11 QUESTION: -- as opposed to claim preclusion --

12 MR. AYER: Yes, Your Honor --

13 QUESTION: -- or res judicata?

14 MR. AYER: The -- the Miller Building case and
15 the Barnes case, both of those cases involved collateral
16 estoppel. It was invoked by a new party, and it was
17 clearly based upon the fact that the -- that the matter
18 had been -- in one case, it was a voluntary stipulation
19 with prejudice. The other was a voluntary --

20 QUESTION: Well, was it a stipulation that --
21 that expressly addressed the -- the fact issue?

22 MR. AYER: I don't believe you can tell from the
23 opinion, and that's not, certainly, what they rely on.
24 The principle that is stated in those cases in a -- in a
25 categorical way, and I can -- I can read it to the Court,

1 is that -- let's see.

2 QUESTION: May I read you the language from
3 McInnis, which is the North Carolina supreme court? It
4 was not just simply a statement that, we recognize issue
5 preclusion in its traditional guise. It was, issue
6 preclusion does not apply unless, quote, the prior suit
7 resulted in a judgment on the merits, identical issues are
8 involved, the issue was actually litigated, the issue was
9 actually determined.

10 Now, you're asking us to reject that as the law
11 of the -- North Carolina.

12 MR. AYER: Well, I -- I think, Your Honor, there
13 are -- there are many Federal court cases that recognize
14 that a matter which is not actually litigated in the sense
15 that it went to trial and was determined after a trial or
16 a fact-finding. If the parties intend for a settlement
17 agreement to be preclusive, and that is incorporated into
18 a judgment, that will have collateral estoppel effect, and
19 that's what happened --

20 QUESTION: Well, are you relying on -- I thought
21 you were relying on North Carolina law.

22 MR. AYER: We are. I'm simply trying to point
23 out that the notion that there is some sweeping,
24 overarching general law that says it always must be
25 actually litigated, that that, in fact, is not correct.

1 QUESTION: No, I -- no, no, we made it plain,
2 and I don't think there's any question here that the
3 parties can stipulate, and the stipulation will have --
4 will have the same effect as a finding, but, as the
5 Restatement of Judgments points out, that must be made
6 manifest. You don't imply it from words that don't say,
7 and we stipulate that this claim is going to be
8 dischargeable in bankruptcy.

9 MR. AYER: Well, what -- let me suggest to the
10 Court a -- a way in which this was clear. First of all,
11 I -- I do really want to emphasize that -- that all three
12 of the opinions of the court below, none of them adopt
13 this sort of categorical, it's a contract, therefore the
14 right is waived approach. That is not the issue in any of
15 these cases. They all look at the specific language, and
16 they reason to the conclusion.

17 The -- the court of appeals, for example,
18 specifically said that, quote, a --

19 QUESTION: Where are you quoting from, Mr. Ayer?
20 What page?

21 MR. AYER: Let's see, here. Page 10a of the --
22 of the appendix.

23 QUESTION: Thank you.

24 MR. AYER: The petition appendix.

25 They said, in invoking the novation concept,

1 it's necessary --

2 QUESTION: Whereabouts on the page are you?

3 MR. AYER: It's actually -- I'm sorry, Your
4 Honor, it's -- it's 9a. If you look at the end of the
5 first paragraph, under the novation theory, courts need
6 only address -- wait a minute. I'm sorry, the top of the
7 page on 9a. When following the novation theory, the terms
8 of the settlement should be examined to determine whether
9 the nondischargeability claims were released.

10 The rest of that page is an examination of the
11 terms, and if you look over onto the next page, 10a, they
12 quote the West case, which says, a promissory note does
13 not discharge the underlying obligation unless the parties
14 expressly release and substitute the new. That is what
15 these cases are all about, all three of them, and the
16 question of whether the settlement released the claim is a
17 question, I would submit, in the first instance -- not in
18 the last instance, but in the first instance, it's a
19 question of State law, and --

20 QUESTION: I think there's no dispute that the
21 settlement released the claim. There's no dispute that
22 there was a novation here. There's no dispute that they
23 no longer have the original fraud claim. They have a
24 claim only on the promissory note that they got as a
25 result of the settlement, so it -- they're -- they're not

1 claiming, oh, we can go back to the day we filed our fraud
2 complaint. They're saying, we have a debt here, a
3 promissory note, and that is the sum total of what we can
4 claim

5 MR. AYER: Right, but Your Honor, the -- the
6 holding of all the courts below went beyond what Your
7 Honor is saying.

8 QUESTION: The words that you read --

9 MR. AYER: Well --

10 QUESTION: -- are simply supportive of that --

11 MR. AYER: -- let me -- let me --

12 QUESTION: -- but you can't -- you can't get
13 anything more than the amount of the promissory note that
14 results from the settlement.

15 MR. AYER: Well, let me refer the Court, for
16 example, to 35a of the petition appendix, where it is
17 stated that, quote, by including in the release future
18 claims --

19 QUESTION: What -- what is this from, this is
20 the opinion of the bankruptcy court?

21 MR. AYER: This is the opinion of the bankruptcy
22 court. I'm just trying to -- this was the consistent
23 analysis in all of these courts. By including in the
24 release future claims, the court concludes that the
25 plaintiffs effectively released and extinguished the

1 dischargeability claim which they now seek to assert.

2 QUESTION: Well, that's a new, different issue
3 than we granted, isn't it? I mean, that's -- the
4 question, I take it, is, we're assuming there's a
5 novation, there's a settlement, and fine, and that
6 settlement says, I promise to pay \$200,000, so it's a
7 debt. It's a debt for money, and the question is, is it a
8 debt for money obtained by actual fraud?

9 MR. AYER: Well --

10 QUESTION: If so, how do we characterize that
11 debt?

12 MR. AYER: I --

13 QUESTION: You're saying it was, but it was
14 released. I -- I don't see that we reach that.

15 MR. AYER: Well, whether -- whether this is a
16 different issue than you granted, I guess -- I -- I agree
17 that the question as it was presented in the petition --

18 QUESTION: Yes.

19 MR. AYER: -- is most easily read as this broad,
20 blanket rule. That is not --

21 QUESTION: Well, I -- I would assume that the
22 text and the wording here that you're relying on, and the
23 rule of the State about a novation and so forth, are --
24 are prevalent, not universal, but are -- are the standard
25 form of -- of settlement and release in almost every

1 State, and apparently the novation rule is standard as
2 well, so the -- the result that you're asking us to reach
3 is that this also forecloses any Federal characterization
4 of this as being a debt incurred by fraud, and -- and
5 that's a very sweeping statement, and a very sweeping
6 rule.

7 MR. AYER: Well, I -- I think -- I think there
8 is -- I think the ultimate question, and the last question
9 and the fourth question I'm hoping to get to, and I will
10 get to now, is the question of, if -- if you agree with me
11 for purposes of argument that initially, you look to see
12 what the State settlement does and, indeed, here also what
13 the effect under State law of the voluntary discharge with
14 prejudice is -- voluntary dismissal with prejudice is,
15 and -- and you see, as these courts below held, that the
16 effect is, in fact, to give up the right, then the
17 question is, is there something about Federal bankruptcy
18 law or policy that prevents parties from voluntarily
19 agreeing to do that?

20 QUESTION: May I go back just one step? Suppose
21 this settlement had been entered as a consent judgment,
22 just as was the case in Brown against Felsen, what then?

23 MR. AYER: I think it would depend, Your Honor,
24 what was in the consent judgment.

25 QUESTION: Nothing. The Court just enters --

1 there's -- the parties' settlement is incorporated in the
2 consent judgment.

3 MR. AYER: I -- I think it would become a
4 question of whether, under the laws of the place where the
5 consent judgment is entered, the fact that there's a
6 settlement that is somehow appended to that order, if it's
7 appended, whether that becomes limiting or defining of the
8 terms of what's agreed to.

9 If all you have -- I would agree with this. If
10 all you have --

11 QUESTION: Wasn't -- in -- in Brown against
12 Felsen, there wasn't -- the settlement was not on the
13 record?

14 MR. AYER: There's -- there's no discussion,
15 Your Honor. In fact, what's pretty clear in Brown versus
16 Felsen, and the critical difference between Brown and this
17 case is that there was no -- there was no kind of any
18 release of a fraud claim. You simply had the settlement,
19 and the -- the creditor got paid, and -- and nobody had
20 yet proven affirmatively that there was fraud.

21 What this Court said is, on those facts, you get
22 to come in and prove fraud.

23 QUESTION: Okay, so you're -- you're then
24 conceding the following, is that right, that if, in fact,
25 I owe you \$300,000 because I cheated you by fraud, we then

1 enter into a settlement which might be approved by the
2 court, assume it is, and what that settlement says is, in
3 light of what you claim I did to you, cheat you through
4 fraud, I promise to pay \$200,000, and you are conceding
5 that that's all there is to the case, that that is
6 nondischargeable?

7 MR. AYER: I -- I am at least conceding that
8 there's no waiver of the right to argue --

9 QUESTION: Well, I want to know on my -- the
10 facts I just gave you --

11 MR. AYER: Well, it -- it --

12 QUESTION: -- in your opinion --

13 MR. AYER: Your --

14 QUESTION: -- is that 200,000 debt
15 nondischargeable?

16 MR. AYER: If it amounts to a clear concession
17 that there was fraud, yes.

18 QUESTION: No. What I'm saying is, you have the
19 facts I gave you.

20 MR. AYER: Okay.

21 QUESTION: Remember what they were.

22 MR. AYER: In consideration of --

23 QUESTION: You said it was \$300,000 obtained by
24 fraud. I said, I will settle that by entering into this
25 piece of paper which says, I promise to pay 200.

1 MR. AYER: I -- I would say --

2 QUESTION: Approved by the court.

3 MR. AYER: I would -- I would say that that is

4 non -- that is not nondischargeable without affirmatively

5 proving fraud, although you would --

6 QUESTION: There are -- there are too many

7 negatives in your statement.

8 MR. AYER: Well, you --

9 QUESTION: I'm lost.

10 (Laughter.)

11 MR. AYER: That leaves --

12 QUESTION: I give -- remember my example. I

13 want to say, in your opinion, is that nondischargeable,

14 yes or no?

15 MR. AYER: It is not non -- it is --

16 (Laughter.)

17 MR. AYER: It is not clear from the hypothetical

18 that it is nondischargeable, but it is certainly not --

19 you have the opportunity to come into bankruptcy court and

20 prove fraud. Your -- your hypothetical does not establish

21 fraud.

22 QUESTION: Oh, okay, but you're saying you have

23 an opportunity --

24 MR. AYER: Yes.

25 QUESTION: -- to prove the fraud?

1 MR. AYER: Absolutely.

2 QUESTION: And your case is different from that

3 in -- I gave in which respect?

4 MR. AYER: In the respect --

5 QUESTION: In the release?

6 MR. AYER: In the respect that our case included

7 language which was interpreted by all three of these

8 courts as a release -- under State law as a release of the

9 right to go to bankruptcy court and pursue --

10 QUESTION: Fine, and the reason that's in the

11 question presented is?

12 QUESTION: Yes, it isn't in the question

13 presented, that's what I thought.

14 MR. AYER: The reason it's in the question

15 presented is because it's -- it is the holding of the case

16 below.

17 QUESTION: Well --

18 MR. AYER: The case below doesn't --

19 QUESTION: -- the -- the question presented,

20 Mr. Ayer, is whether a debt that would otherwise be

21 nondischargeable becomes dischargeable if the parties

22 enter a settlement agreement under which the amount of the

23 debt is -- it literally doesn't say anything about fraud

24 or collateral estoppel.

25 MR. AYER: That's correct, Your Honor. I guess

1 what I would say is that that question is --

2 QUESTION: You're answering the question. You
3 just want to answer it, maybe, right?

4 MR. AYER: Well, that's right. The answer is
5 maybe, and it depends --

6 QUESTION: Sometimes yes, sometimes no.

7 MR. AYER: -- and what it depends upon is, has
8 there been a basis on which to conclude that that right
9 has been given up, and the answer is that no such basis
10 arises simply because there's a settlement contract. We
11 do not claim that, and neither did any of the courts
12 below. There -- there's nobody here in this courtroom or
13 in this case who says, that's the rule of law. That you
14 can say it's not the rule of law and everybody will agree
15 with you, but that's not the issue in the case.

16 QUESTION: Okay, taking your terms, everybody, I
17 guess, agrees that if the settlement agreement said, we
18 agree, the two parties, that there was no fraud involved
19 in the creation of the debt which this agreement settles,
20 that that would, in fact, be preclusive, that they could
21 not, in fact, prove fraud and -- and nondischargeability.
22 Why is the settlement here like the settlement I just
23 described, because that, as I understand it, is your
24 argument. There's no legal difference between the
25 settlement we've got here, which says nothing about fraud,

1 and the settlement that I described in which fraud is
2 expressly addressed. Why are the two alike?

3 MR. AYER: Well, one reason why, and this --
4 this gets back to my point that I think you have to take a
5 State court settlement under State law first to understand
6 it, this -- this settlement, among the other language of
7 releases which we've talked about, also includes language
8 that commits to filing a voluntary dismissal with
9 prejudice.

10 Now, as I've indicated, in order --

11 QUESTION: Well, isn't -- isn't that what any
12 neither party settlement does?

13 MR. AYER: Well, it may or may not, Your Honor,
14 but in this case in North Carolina, under North Carolina
15 law, under Miller Building and Barnes, when you file a
16 voluntary dismissal with prejudice, it is as though the
17 matter were litigated to a conclusion and the plaintiff
18 lost, and --

19 QUESTION: I thought that --

20 QUESTION: So far as --

21 QUESTION: I thought that was true, certainly
22 true as far as claim preclusion goes.

23 MR. AYER: Right. It's --

24 QUESTION: It's claim-precluded, but you
25 constantly mixed up --

1 MR. AYER: Well --

2 QUESTION: -- claim preclusion and issue

3 preclusion --

4 MR. AYER: Well, Your Honor --

5 QUESTION: -- and yes, a voluntary dismissal

6 with prejudice is preclusive of that claim. You can never

7 bring that claim again, but it resolves no issues.

8 MR. AYER: Well, Your -- Your Honor, that --

9 that is the law in many places. That is not the law in

10 North Carolina, and I simply -- I know this Court doesn't

11 spend its time deciding State law issues, but --

12 QUESTION: I haven't seen a single North

13 Carolina supreme court decision that so holds, that a

14 voluntary -- I thought that North Carolina rules, by the

15 way, were based on the Federal rules with respect to the

16 voluntary dismissal rule. Isn't that so?

17 MR. AYER: I -- I think the rules are somewhat

18 similar. I've not studied them to know how precisely

19 parallel they are.

20 QUESTION: And -- and the voluntary dismissal is

21 claim-preclusive but not issue-preclusive?

22 MR. AYER: Well, let me -- let me just quote,

23 because I -- I've found it -- the language in Miller

24 Building and Barnes is that a voluntary dismissal with

25 prejudice, quote, precludes subsequent litigation to the

1 same extent as if the action had been prosecuted to a
2 final adjudication adverse to the plaintiff.

3 QUESTION: All right, Mr. Ayer, let's assume
4 that that particular reason isn't necessarily going to
5 persuade all of us here. Do you have another reason to
6 say that the agreement, the settlement here should be
7 treated in law by this Court under the Bankruptcy Code
8 just like a settlement that expressly says there wasn't
9 any fraud? Do you have any other reason?

10 MR. AYER: I think the language of the release
11 is quite clear. The language of the release talks about
12 releasing any and all rights, including future rights.

13 QUESTION: Well, but it's a question of Federal
14 law as to whether that includes a nondischargeability
15 claim. I mean, that's what we're here to talk about, and
16 I think that's --

17 MR. AYER: Well, let me --

18 QUESTION: -- that's going to be the same in
19 every State, which is what I've asked. The very first
20 question we asked, or I asked, was whether or not this was
21 a rule depends on the -- the vagaries of the law of North
22 Carolina or not.

23 MR. AYER: Well -- and let me suggest, Your
24 Honor, that -- that in order --

25 QUESTION: And I would -- I would have to agree

1 with what Justice -- Justice Ginsburg seems to be
2 indicating, that this -- that what you're saying is that
3 there's issue preclusion as to an issue that's never been
4 litigated.

5 MR. AYER: Well, and the parties --

6 QUESTION: That's astounding.

7 MR. AYER: But I think we know under Arizona v.
8 California and other decisions that parties can do that if
9 they in -- if they indicate an intention to do it, and the
10 question is, have they done that here.

11 Let me --

12 QUESTION: Can I ask -- this -- this puzzles me.
13 Is it, indeed, a question of Federal law whether a
14 contract which -- which gives up all future rights in
15 connection with this claim includes -- whether -- whether
16 the contract includes the right to claim
17 nondischargeability?

18 MR. AYER: No, Your Honor.

19 QUESTION: Is -- is that a Federal question or a
20 State question?

21 MR. AYER: I think -- I believe it's not, and I
22 really feel --

23 QUESTION: What do you -- you think it's a
24 question of State law?

25 MR. AYER: I believe it's a question of State

1 law.

2 QUESTION: It's a question of Federal law what
3 the consequence --

4 MR. AYER: Correct.

5 QUESTION: -- of that State contract is.

6 MR. AYER: Absolutely.

7 QUESTION: Okay.

8 MR. AYER: And let me address, if I could, what
9 I view as the logical way to think about this. Once you
10 have a State contract that is given meaning under State
11 law, the question is, is that somehow to be modified or
12 overridden in light of Federal bankruptcy policy, and what
13 we have here, on the other side, I think, are two
14 different views.

15 We have one view of the petitioners that it can
16 never be done, there's no way, bankruptcy policy won't
17 allow it, and the other view of the Government is that,
18 well, you can do it if it's clear enough, and then you get
19 into nice questions of what, I guess, our Federal common
20 law --

21 QUESTION: Your view, Mr. Ayer, would simply
22 encourage anticipatory litigation of issues that might
23 arise in bankruptcy, which I think Brown suggests is not a
24 good idea.

25 MR. AYER: Your Honor, I think all -- all our

1 approach does is allow parties to enter into settlements
2 to be given what effect they have.

3 QUESTION: Well, but, I -- I think here, too,
4 probably there's general agreement. If in so many words
5 you say in the State court settlement, I waive my right to
6 claim nondischargeability in bankruptcy, probably
7 everybody would say, or a majority would say yes, but you
8 don't have that here.

9 MR. AYER: Well, what it -- I mean, I guess the
10 next question would be, what else might be adequate, and
11 do you really want to develop a -- a body of Federal law.
12 Let me, if I could, just point to the arguments on the
13 other side why this should be treated as essentially a
14 Federal override of State law interpretive principles is
15 based first upon citation of a number of express
16 provisions of the Bankruptcy Code which have nothing to do
17 with the subject and, I think, prove the opposite point.

18 There's a whole section on debtor reaffirmations
19 which set up detailed procedures that the bankruptcy court
20 enforces to make sure that debtors don't get taken
21 advantage of, and they are specific, and they're clear,
22 and the bankruptcy court follows them. That's an occasion
23 for the bankruptcy court to get involved.

24 There's the idea that the automatic stay cannot
25 be voluntarily given up. Again, that's the product of

1 specific language that creates an automatic stay to
2 protect the debtor and has 18 itemized exceptions,
3 specific language. There -- they invoke the preference
4 provisions which let, of course, the bankruptcy court go
5 back into transactions that occur prior to bankruptcy, and
6 look at them on very specific terms set forth in section
7 547. They talk about the fraudulent conveyance section
8 does the same thing in a slightly different way, but there
9 are no such provisions whatsoever with regard to waivers
10 of section 523 claims. Section 523 claims are something
11 that the creditor loses if he does not affirmatively file
12 within 60 days of the first meeting of creditors. There
13 are no protections with regard to that in the code, and
14 if -- if something isn't filed, they disappear.

15 Indeed, the whole idea that creditors are --
16 that -- that the issues with regard to nondischargeability
17 under (a)(2), (a)(4), (a)(6), and (a)(15), are made a
18 matter of exclusive Federal jurisdiction, the reason for
19 that, and your case and Brown talk specifically about
20 that, is because creditors were abusing the process by
21 pursuing them. This is not a protection for creditors.
22 This is a -- a way of making sure creditors don't come in
23 after bankruptcy and basically put the screws to -- to
24 debtors who have gotten a discharge.

25 What language there is -- and we talk about this

1 in both the briefs, I think specific language runs counter
2 to this. We talked in the briefs about (a)(11) and
3 (a)(19), which specifically mention settlements, and I
4 would submit the better interpretation of that language is
5 to say, in those instances where the language specifically
6 says that any settlement may give rise to a
7 nondischargeable claim, is to allow the bankruptcy court
8 to go back in and look at those facts even if the right to
9 a nondischarge -- right to pursue nondischarge was given
10 away.

11 I think the bottom line is that the arguments on
12 the other side relate to a series -- they don't relate to
13 any language of the code, other than the much overbroad
14 idea that it -- that it's any debt, and of course that
15 doesn't mean that a party can't be foreclosed from
16 litigating the 523 claim because he's already lost it in
17 State court, so any doesn't mean absolutely every.

18 The policies that are invoked are, first, the
19 honest but unfortunate debtor policy, but nobody here,
20 I think, seriously suggests that a party can't give the
21 thing away, give the right away if they want to, and so
22 I think -- give the right to pursue the 523 action away by
23 clear enough language. That seems to be the -- the
24 petitioner I think disagrees with me, but other than that,
25 I think the better view is that they can, and I don't

1 think this Court in any of its cases has ever suggested
2 that the honest but unfortunate debtor policy forecloses
3 relying on prior resolutions under State law. Collateral
4 estoppel certainly applies, and we think settlement
5 language that's clear ought to apply.

6 They claim that allowing this is some sort of a
7 trap for the unwary. It would be a trap if the rule were
8 this categorical rule that says, boy, you enter into a
9 settlement contract, you lose your 523 claim. That's not
10 the issue in the case. The issue is, does the language
11 here support the -- the idea that the -- the right to
12 pursue the 523 claim has been given up, and to hold
13 parties to the State law effect of releases that they sign
14 is no trap for the unwary. That's how we do litigation in
15 this country every day.

16 QUESTION: Mr. Ayer, may I ask you this
17 question: You started out telling us you were going to
18 make four points. I know what one, two, and four are, but
19 I'm just curious as to what three was.

20 MR. AYER: Three was the State law point. I --
21 I guess -- three was the point that when you look at State
22 law here, the reading of -- the fair reading of State law
23 does, indeed, support the State law rulings of all three
24 of the courts below, and point four, of course, is that
25 there's no reason in Federal law to go back and say no, we

1 have to second-guess that.

2 QUESTION: I -- I suppose after this case, no
3 matter which way it goes, you can have an Archer clause
4 in -- in the settlement agreement. I -- I've never seen a
5 settlement agreement in which the parties agree that it's
6 going to be nondischargeable. As a matter of common
7 course, do these clauses appear in contracts, or --

8 MR. AYER: I'm not aware of it, Your Honor.
9 They certainly can if they want to.

10 QUESTION: I know they can.

11 QUESTION: Thank you, Mr. Ayer.

12 MR. AYER: Thank you, Your Honor.

13 QUESTION: Mr. Goldblatt, you have 4 minutes
14 remaining.

15 REBUTTAL ARGUMENT OF CRAIG GOLDBLATT

16 ON BEHALF OF THE PETITIONERS

17 MR. GOLDBLATT: Okay. Thank you. I only have
18 four points. First, with respect to the State law
19 question of preclusion, we say in our reply brief on pages
20 7 and 8 that that issue had been waived. I don't want to
21 belabor that point, but I -- I will point out that the
22 brief respondent filed in the court of appeals, which
23 is -- which is, of course, in the record here, states
24 State law correctly. There, on page 29 in the court of
25 appeals respondent said, there is no issue of collateral

1 estoppel in this case because there have never been any
2 evidentiary findings.

3 We submit that's a correct statement of State
4 law. None of the North Carolina cases cited by respondent
5 involved a case in which a settlement agreement is given
6 preclusive effect.

7 Second, with respect to the language of this
8 particular release, it would certainly present a harder
9 case if you had a situation which the release said, we
10 give up all of our rights in bankruptcy, and in the event
11 you file for bankruptcy, we will not make any effort to
12 collect on the debt. This release is quite far from that,
13 and expressly preserves the right at all points to recover
14 on the amount that was promised in the promissory note,
15 and this Court's opinion in Brown makes clear as a matter
16 of Federal law that what a nondischargeability action is
17 is simply an action to enforce the obligations that were
18 promised as part of the settlement.

19 Finally, the question of the form of the debt,
20 and whether the form of the debt drove the decision below,
21 there -- the Court of appeals certainly does say -- and
22 this is in the joint appendix at page 8 -- I'm sorry,
23 page 9a, footnote 8. It explains quite clearly that a
24 basis for its decision is the notion that the creditor was
25 substituting the tort claim, the fraud claim for a

1 contract claim and rests its decision on that basis.

2 The consequence of that decision would be that
3 from the creditor's perspective, if a creditor has an
4 unliquidated claim, and this applies not only to claims
5 for fraud but, say, an injury caused by drunk-driving, any
6 of the categories of nondischargeability, if you have an
7 unliquidated claim and they file for bankruptcy, you can
8 contend its nondischargeable.

9 If, on the other hand, you've litigated all the
10 way to judgment, under Brown you can say in bankruptcy,
11 even if the judgment doesn't say what it's for, that
12 that's nondischargeable. It would create an anomalous
13 situation in which the middle category, cases that are
14 resolved in settlement agreements that don't resolve the
15 question of liability, the rights in bankruptcy to show
16 nondischargeability is given up, and because the code
17 makes clear that the form of the debt is irrelevant to
18 persons of dischargeability, and because this Court's
19 decision in Brown versus Felsen is essentially
20 indistinguishable from this case, we submit the decision
21 below should be reversed.

22 QUESTION: It's rather unfortunate,
23 Mr. Goldblatt, that there's nobody in the room to defend
24 the position that I understood was taken by the question
25 presented, namely that a novation -- a novation is all you

1 need. I think that's, at least, an arguable position,
2 but -- but nobody -- nobody seems to want to --

3 MR. GOLDBLATT: We agree that -- that --

4 QUESTION: -- discuss the issue on -- on which
5 we took the case.

6 MR. GOLDBLATT: Your Honor, we -- we agree, as
7 we say in our reply brief, that the principal basis of the
8 decision below has been abandoned by respondent here, and
9 we believe it's been abandoned because it can't be squared
10 with this Court's decision in Brown versus Felsen, which
11 holds squarely to the contrary.

12 QUESTION: Thank --

13 QUESTION: What about the (a)(11) and (a) -- the
14 19, the express provisions for nondischargeability?

15 MR. GOLDBLATT: Your Honor, what Congress was
16 doing in -- in sections (a)(11) -- I -- I see my time
17 has -- has run out, but what Congress was doing in (a)(11)
18 and (a)(19) was giving preclusive effect --

19 CHIEF JUSTICE REHNQUIST: Thank you,
20 Mr. Goldblatt. The case is submitted.

21 (Whereupon, at 11:04 a.m., the case in the
22 above-entitled matter was submitted.)
23
24
25